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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 120.

HOWARD S. PALMER, JAMES LEE LOOMIS and HENRY B. SAWYER, Trustees of the Property of The New York, New Haven and Hartford Railroad Company, Debtor,

Petitioners,

—against—

WEBSTER AND ATLAS NATIONAL BANK OF BOSTON, Trustee,

Respondent.

REPLY BRIEF FOR PETITIONERS.

HERMON J. WELLS,
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Of Counsel.

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INDEX.

PAGE

(1) Respondent's brief fails to answer our argument that Section 124a and Section 124 do not require petitioners to pay Terminal Company taxes and bond interest out of the New Haven estate 1

A. Respondent's argument as to Section 124a. 2

B. Respondent's argument as to Section 124.. 3

(2) Respondent's brief fails to answer our argument that the Act of 1896 does not apply to the New Haven after the Old Colony lease had ended and use of the terminal on behalf of the New Haven had ceased 5

(3) Respondent's brief fails to answer our argument that the interpretation made by the court below of Sections 124 and 124a taken in connection with Section 77(c)(6) violates the due process clause of the Fifth Amendment to the Constitution of the United States..... 11

Conclusion 16

Table of Cases:

	PAGE
Hennepin County, Minn. v. *M. W. Savage Factories, Inc.*, 83 F. (2nd) 453 (C. C. A. 8th, 1936)	3
MacGregor v. *Johnson-Cocdin-Emmerich, Inc.*, 39 F. (2nd) 574 (C. C. A. 2nd, 1930)	3
Palmer v. *Massachusetts*, 308 U. S. 79 [1939]	12
Palmer v. *Palmer*, 104 F. (2d) 161, C. C. A. 2d 1939, cert. den. 308 U. S. 590 [1939]	7
Warren v. *Palmer*, 310 U. S. 132 [1940]	7

Other Authorities:

Act of June 18, 1934, 48 Stat. 993 (28 U. S. C. A., Sec. 124a) 1, 2, 11, 13, 14

Bankruptcy Act, Sec. 77(c)(6), 2, 3, 4, 5, 6, 7, 9, 11, 12, 12*n*, 13, 14, 15

Constitution of the United States, Fifth Amendment. 11

Judicial Code, Sec. 65 (28 U. S. C. A., Sec. 124), 1, 3, 4, 4*n*, 11, 13, 14

Massachusetts Acts and Resolves, 1896, ch. 516, Sec. 10, 5, 6, 8, 9, 9*n*, 11, 15

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REPLY BRIEF FOR PETITIONERS.

(1) *Respondent's brief fails to answer our argument that Section 124a and Section 124 do not require petitioners to pay Terminal Company taxes and bond interest out of the New Haven estate.*

Only nine pages of respondent's 65-page brief (pp. 49-58) are devoted to the principal issues in the present appeal—*viz.*, the meaning of Sections 124a and 124 with relation to property in the New Haven estate (compare Petitioners' Brief, subdivisions 2 and 3, pp. 17-40). Respondent tacitly admits the weakness of the decision of the Circuit Court of Appeals by directing most of its brief to arguing matters deemed by that Court to be unnecessary to decide.

A. Respondent's argument as to Section 124a.

Respondent's argument as to Section 124a may be summarized thus:

> Petitioners are trustees or agents appointed by a United States court. They are authorized to conduct, and they are conducting the business of Old Colony and Boston and Providence as agents of the court under Section 77(c)(6). The taxes are State and local taxes applicable to the business of Old Colony and Boston and Providence. Therefore petitioners must pay the taxes.

Even if this argument were sound* it would merely prove that petitioners are described by the statute and obligated to pay the taxes, and would fall far short of sustaining the proposition respondent must sustain in order to procure affirmance of the judgment below—namely that the statute requires petitioners to pay the taxes *out of New Haven funds*. We have shown that the statute lays down no such requirement (Petitioners' Brief, subdivisions 2C and D, pp. 22-33), and respondent has not even attempted to answer our argument save by a mere assertion (Respondent's Brief, p. 51) that if necessary petitioners must go to New Haven funds for payment.

Respondent's approach to the problem is substantially that of the Circuit Court of Appeals (Respondent's Brief, p. 50). That court, without hearing argument on the point and believing that petitioners were described by Section 124a and that they were obligated by that section to pay the taxes, jumped immediately to the conclusion that payment should be made out of New Haven funds. Petitioners are certainly not, as respondent alleges,

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* Compare petitioners' brief, subdivision 2B, pages 17-22.

"policy determiners of the Old Colony and Boston & Providence" (Respondent's Brief, p. 58). Thus it was the Old Colony Trustees who filed the Old Colony's Boston Group Abandonment Petition (Cf. I. C. C. Finance Docket No. 12614 referred to at p. 20 of Our Main Brief), in which the New Haven Trustees joined only as operators of the Old Colony's lines. But what we wish particularly to emphasize here is that even if respondent and the Circuit Court of Appeals are right in their premise that the statute gives rise to a liability of petitioners as operators of the Old Colony and Boston and Providence lines, it by no means follows that the liability should be discharged from New Haven funds.

On behalf of the New Haven estate, petitioners rejected the Old Colony lease, carrying with it both the Old Colony and Boston and Providence properties. This rejection meant that they considered the lease a burden, and not a benefit, to the New Haven estate and that they refused to adopt that burden. But under Section 77(c)(6) they were compelled to continue operation of Old Colony and Boston and Providence properties. They had no option as to this. They could not have refused and thus do not come within the rule stated by Judge Learned Hand in *MacGregor* v. *Johnson-Cowdin-Emmerich, Inc.*, 39 F. (2nd) 574, 576 (C. C. A. 2nd, 1930), that receivers should refuse to accept property they think burdensome. This rule, recognized also in *Hennepin County, Minn.* v. *M. W. Savage Factories, Inc.*, 83 F. (2nd) 453, 455 (C. C. A. 8th, 1936), has no application to the present case. Petitioners' operation is for the account of the former lessors and not for the benefit of the New Haven estate.

B. *Respondent's argument as to Section 124.*

Here, also, respondent fails to meet the issue before this Court as to the meaning of Section 124, but contents

itself with insisting merely that petitioners are described by the statute and are using the terminal. Respondent has failed to point out why payment should be made from New Haven funds.

Respondent also fails to advance any convincing reasons why a statute, such as Section 124, dealing with "operation" should be tortured into a direction to pay debts not necessary to operation. And the penalty provided for violation of the Section* is inappropriate to a statute dealing with payment of money. Instead of fine and imprisonment we should expect to find a penalty in the nature of interest, as with tax statutes, if respondent were right. Surely the inclusion of such penalties indicates that the statute was not intended to apply to such payments.

Under Section 77(c)(6) the use of the terminal by petitioners over the lines of Old Colony and Boston and Providence is a use "for the account of the former lessors". It is not a New Haven use. Accordingly, there is no reason why the New Haven estate should pay for this use (compare Respondent's Brief, pp. 56-57), and the fact that "the items involved in the present case represent current charges" (Respondent's Brief, p. 57) does not aid respondent at all. The current charges are current charges of Old Colony and Boston and Providence and should be paid from the properties of those companies. See also petitioners' brief, pages 37-39. The order appealed from (Order No. 398, R., p. 20) did not authorize use of the terminal without compensation or decide that certain items (viz., taxes and bond interest) prescribed by the Massachusetts statute should not be paid from Old Colony and Boston and Providence estates (compare Respondent's

* "Any receiver or manager who shall willfully violate any provision of this section shall be fined not more than $3000, or imprisoned not more than one year, or both" (Sec. 124, quoted p. 50 of Petitioners' Brief).

Brief, pp. 38, 39, 47, 48, 63). It was entered after a finding that the Massachusetts Act of 1896 no longer applied to the New Haven, and it merely directed that the taxes and bond interest should not be paid *from New Haven funds*, thereby leaving the obligation with Old Colony and Boston and Providence estates. The present case raises no question whether use by Old Colony and Boston and Providence should continue without payment by them.

(2) *Respondent's brief fails to answer our argument that the Act of 1896 does not apply to the New Haven after the Old Colony lease had ended and use of the terminal on behalf of the New Haven had ceased.*

Respondent devotes the bulk of its brief (subdivisions (A) to (F) inclusive, pp. 10-48) to an attempt to show that the Act of 1896 still applies to the New Haven after the Old Colony lease had ended (as respondent admits it had—Brief, p. 41) and after the New Haven's use of the terminal ceased. The whole argument in the earlier portion of the brief (with the possible exception of subdivision (F)(2), pp. 45-48) is founded principally on an assumption that the New Haven trustees are using the terminal in their operation of the New Haven property, for only thus can respondent make out a New Haven use upon which a New Haven liability would necessarily depend (Section 10 of the Act of 1896).

Under Section 77(c)(6) the primary obligation to operate after rejection is placed specifically on the "lessor", and a secondary obligation arises in the "lessee" only in the event that "it would be impracticable and contrary to the public interest for the lessor to operate", in which event the lessee continues operation *"on or for the account of the lessor"*. It follows from the very section upon which respondent so heavily relies (Brief, subdivi-

sion (E), pp. 43 *et seq.*) that petitioners' operations into the terminal are not operations for the New Haven, but for the Old Colony and Boston and Providence estates.

The crux of respondent's argument appears on pages 29 to 31 of its brief, where it makes the most extreme statements contrary to the facts of record in this case and contrary to express provisions of Section 77(c)(6). It says (Brief, p. 29) that "the New Haven trustees continued to operate the business of the New Haven Railroad Company and continued to use the terminal facilities in the same way as they were used prior to the bankruptcy". This is just not so and therefore it will not support the conclusion that "the trustees of the New Haven were bound directly under the Massachusetts Act of 1896". Before bankruptcy the New Haven operated the lines of Old Colony and Boston and Providence for its own account. After rejection of the leases, when the Old Colony and Boston and Providence found themselves unable to operate, the petitioners were compelled to do so—but for the account of the former lessors.* Also, on the same page of its brief, respondent states that the revenues from terminal operations benefited the New Haven estate. This is not true. Use of the terminal for the period here involved was due solely to the operation of Old Colony and Boston and Providence lines. This latter operation has required advances by the New Haven estate in excess of $20,000,000 for the period from October 23, 1935, to and including December 31, 1939,—a loss to which terminal operations have contributed handsomely (see Petitioners' Brief, p. 5, for record citations). Thus respondent is driven to a claim that operating deficits are beneficial to the New Haven estate.

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* This is clearly alleged in the verified petition upon which the order here in issue was made (R., pp. 4-11), the respondent having expressed itself as quite content to stand on the petition (R., p. 31).

Respondent's statements on pages 29 to 31 of its brief ignore what has occurred during the reorganization proceedings, including decisions of the Circuit Court of Appeals (*Palmer* v. *Palmer*, 104 F. (2d) 161, C. C. A. 2d 1939, cert. den. 308 U. S. 590 [1939]), and this Court (*Warren* v. *Palmer*, 310 U. S. 132 [1940]). If the Old Colony and Boston and Providence leases had terminated by lapse of time, no one could deny that the Old Colony and Boston and Providence estates would be liable for terminal charges and not the New Haven estate. Yet respondent ignores the termination of those leases through bankruptcy proceedings, the absence of a New Haven use of the terminal, the accounting proceedings of Old Colony and Boston and Providence in accordance with the above cited decisions and the express provision of Section 77(c)(6) that operations are for the account of the former lessors. Respondent is forced (p. 31) to the admission that "legal relationships between the New Haven, the Old Colony and Boston and Providence may have changed". Indeed they have; but respondent finds it necessary to ignore these changes in order to sustain its argument that matters stand now just as they stood before reorganization proceedings started.

The present case would stand differently if the Boston and Providence and Old Colony had merged into the New Haven, for in that event use of the terminal over Old Colony and Boston and Providence lines would be a New Haven use. Respondent even goes so far as to claim there has been such a merger (Respondent's Brief, p. 23), but this claim cannot be taken seriously. Indeed, the fact that respondent has built its argument on such a claim is in itself a good indication that the argument is without any real foundation.

Respondent also attempts to show a present New Haven use of the terminal from the fact that in 1931 the De-

partment of Public Utilities of Massachusetts determined under Section 10 of the Act of 1896 that the proportion of use was 70% by the New Haven and 30% by the New York Central. The suggestion is (see Respondent's Brief, pp. 2, 4, 5, 8, 9, 18, 19, 26, 27, 28, 29, 30, 32, 35, 38, 43, 44) that even if no New Haven use of the terminal is made in fact this Court must shut its eyes to that fact because of the Department's determination. Such an argument presents a twofold difficulty. In the first place the New Haven is no longer one of "said railroad companies" within the Act of 1896. In the second place Section 10 of that Act requires said railroad companies to pay the Terminal Company only "for such use" as they make of the terminal. If there is no use there can be no payment; and if there is no use the Department of Public Utilities is given no authority by the Act to determine that there is a use. When it made its determination in 1931 there was an admitted use by the New Haven, which was then lessee of the Old Colony and Boston and Providence properties.

The correct explanation for the requirement of Section 10 that the Department shall determine the terminal use proportion is to be found in respondent's brief, page 27, where it is stated that the "proportion of use was bound to vary at different times and could not have been determined once and for all by the Act". So viewed, Section 10 provides a sensible scheme for administrative determination of a variable at designated intervals, not for the perpetuation of a liability for any period of time during which there is *no use* of the terminal by one of "said railroad companies". In fact, as we have suggested in our brief (pp. 14-15), the order of the Department upon which respondent so heavily relies (Respondent's Brief, pp. 2, 4, 5, 8, 9, 18, 19, 26, 27, 28, 29, 30, 32, 35, 38, 43, 44) did not even purport to fix a liability upon the New Haven; it

merely fixed a proportion of use as between the two lessee companies then using the terminal and quite promptly left the matter of liability to Section 10 of the Act. The earlier use by the New Haven in its own behalf has simply changed to a use by petitioners, under compulsion of Section 77(c)(6), in behalf of the former lessors who are named in the statute and liable for that use. The order appealed from was not "contrary to the Massachusetts statute and the lawful order of the Massachusetts Department of Public Utilities" (Respondent's Brief, p. 2). Respondent has misstated the issue.

The duty of Old Colony and Boston and Providence estates to discharge their liability to the Terminal Company for the use their lines make of its property was characterized by the Circuit Court of Appeals as a "duty" "no one could gainsay" (R., p. 193, fol. 579). This is evident from the fact that the former lessors are among "said railroad companies" named in Section 2 of the Act of 1896 and liable for use under Section 10. Nevertheless respondent now for the first time claims that they are not liable (Brief, p. 30 note, p. 43), and proceeds to claim petitioners are liable on the ground that someone must be. Such an approach to the problem commences by flying in the face of the State statute and then proceeds to avoid any consideration of the issue presented on the meaning of the State law.*

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* At pages 19-20 of its brief, respondent makes much of the New Haven trustees' brief filed in the Supreme Court of Massachusetts in opposition to an attempt of the Boston and Providence trustees to attack collaterally in Massachusetts, through Section 10 of the Act, Boston and Providence's share of Terminal expenses as already allocated to it by the segregation formula. Respondent offered the brief in evidence at the hearing below on the theory that it was an admission against interest (R., p. 41, fol. 121). But even if the trustees had made an erroneous statement of the law in a brief filed in other proceedings, that statement could not change the law. The most it

[Footnote continued on following page.]

Respondent also claims that "the Act [of 1896] intended the New Haven to be bound so long as its corporate existence continued" (Brief, p. 14). This is indeed a surprising conclusion to reach from legislation that described the New Haven as "lessee" and imposed a liability only during use. But it is perhaps necessary at this point merely to refer to subdivision (1), pages 11 *et seq.* of petitioners' brief for an answer to respondent's argument that a perpetual liability was intended by the Act as drawn. Stock ownership so much emphasized by respondent will certainly not serve as a peg on which to hang such a liability where use in behalf of the New Haven has ceased and the Old Colony lease to the New Haven has ended (see Respondent's Brief, pp. 11-14). Indeed, if respondent

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could do would be to show that the trustees were mistaken. And as a matter of fact, the trustees' brief shows no inconsistency with their present claims. It does not state that either they or the New Haven were then liable to the Terminal Company under the Act, but merely points out (1) that they were operating for the account of Old Colony and Boston and Providence under orders of the Connecticut District Court with the approval of the Massachusetts District Court having charge of the Boston and Providence reorganization proceedings, (2) that they and not the Boston and Providence trustees were using the Terminal for the account of Boston and Providence, (3) that the Boston and Providence trustees were paying nothing, and (4) that the Boston and Providence trustees were attempting to make collateral attack upon the segregation formula. The District Court found in the trustees' attitude "no indication that the New Haven estate in their hands is liable for payments for which after the rejection of the Old Colony and Boston and Providence leases the lessor estates became solely liable" (R., p. 16, fol. 46).

It should be noted that we do not claim, as respondent suggests in its brief, pages 32, 33, that the segregation formula is "binding" on the Terminal Company. The significance of the formula in this case is twofold: (1) it shows an enormous deficit in the operation of property of the former lessors, thereby demonstrating the risk to New Haven creditors of further advances of cash for Terminal Company taxes and bond interest, and (2) it divides the 70% of charges for use of the Terminal between the estates for whose account the Terminal is used.

is right, the New Haven, despite surrender of the Old Colony, Boston and Providence lines and discontinuance of the use of any line into the terminal, might still be liable under the Act of 1896 because it owned an insignificant stock interest in the Terminal Company. This theory is flatly inconsistent with respondent's main argument (Brief, pp. 2, 10, 22, 25, 26, 27, 39, 40, 43, 45, 47-49, 56-58, 63) that liability under the Act of 1896 is dependent on use. Nor do we attach any significance in this connection to the failure of the General Court to increase over its original amount the capital stock of the Terminal Company in 1921 when The New York Central Railroad Company was named as lessee of the Boston and Albany (Respondent's Brief, p. 15). The New Haven was operating into the terminal as lessee when the Terminal Company was organized and its capitalization determined. No real reason is seen why the capital structure of the Terminal Company should have been changed merely because the Albany let its road to the Central.

(3) Respondent's brief fails to answer our argument that the interpretation made by the court below of Sections 124 and 124a taken in connection with Section 77(c)(6) violates the due process clause of the Fifth Amendment to the Constitution of the United States.

In spite of the finding of both the District Court and the Circuit Court of Appeals that payment of taxes and bond interest here in issue is not necessary to continued operation of Old Colony and Boston and Providence lines into the terminal—a finding amply supported by the record and by the fact that such operation has continued despite compliance with the order appealed from—respondent persists in asking payment of

the taxes and bond interest on the ground that operation into the terminal must continue under Section 77(c)(6) (Respondent's Brief, pp. 58 *et seq.*). Only by treating payment of these charges as necessary to operation can respondent even claim that their payment now out of the New Haven estate may be required because of the public interest in continued operation.* But the present case bears no resemblance to *Palmer* v. *Massachusetts*, 308 U. S. 79 [1939]. There expenses of operation of the 88 stations had to be paid if operation were to continue. Here all necessary expenses of operation are being paid, and operation is being continued.

Moreover, the order appealed from did not deprive the public authorities of any taxes nor restrict the fund out of which those taxes would be payable under State law (see Petitioners' Brief, subd. (4), pp. 11-16). Those authorities still have their liens on the property and their rights against those who owe the taxes, that is, the Boston Terminal Company, the Old Colony and the Boston and Providence. As the District Court said (R., p. 19):

> "Nothing in the order, of course, will preclude the Old Colony trustees of the Boston and Providence trustees from paying the taxes on their respective properties if they can find the necessary funds. It is abundantly plain from the reports in these proceedings that the capital of the Old Colony estate has been so drained that its estate in its present condition

* Respondent's brief fairly bristles with the "public interest", but what the brief asks is really payment of bond interest. We have shown (Petitioners' Brief, pp. 46 *et seq.*) that the public interest is not involved in the present case, and respondent admits (Brief, p. 51) that "the paramount purpose of Section 77(c)(6) is, in the interest of the public, to prevent a discontinuance of service."

is utterly without ability to command sufficient new capital to make the payments for which it is liable. Whether the Boston and Providence trustees could obtain a loan sufficient to pay its taxes is not a question for this court."

Indeed, the taxing authorities have never asked for the lifting of any injunctions against tax collection from Old Colony or Boston and Providence estates, nor have they sought to collect from the Terminal Company.

We do not dispute as respondent suggests at page 61 of its brief the constitutionality of the provision for a continuance of operation in the public interest (Sec. 77(c)(6)), or the fact that the privilege of rejection is conditioned, as it always has been in equity cases,* upon a continuance of operation in the public interest. However, we do dispute respondent's claim that rejection is conditioned upon the payment of expenses *not necessary to a continuance of operation*. There is no such condition in the Bankruptcy Act. Our grievance is that the Circuit Court of Appeals "interpreted" one into the Act through Section 124a and Section 124; and in so doing, we think, violated the Fifth Amendment.

It is true that "The Legislative mandate requiring the lessee temporarily, and in the interest of the public, to fulfill its * * * obligation to operate the lessor lines in accordance with law raises no question of reasonableness or unreasonableness" (Respondent's Brief, p. 61). However, such a question *is* raised when that mandate is seized upon as justification for a requirement that cash in the New Haven estate must be used to pay charges of a lessor's estate that are not necessary to continued opera-

* See subdivision (1)(c), pages 5 *et seq.*, of "Brief of Petitioners in Reply to Brief of Respondent" heretofore filed in these proceedings.

tion. Respondent's brief sidesteps this question by the simple process of assuming that it does not exist, and thus it fails to answer our argument that the exaction in the present case is arbitrary, unreasonable and capricious and without substantial relation to the object sought to be attained by Congress.

At page 63 of its brief respondent argues that the approval and consummation of a plan of reorganization of the New Haven would remove from the reorganized company the burden of Terminal Company taxes and bond interest which respondent says are properly imposed on the New Haven estate by Sections 77(c)(6), 124a and 124 before such approval and consummation. However, even if we accept the premise as to the results of a New Haven plan there is no support for the conclusion that the three Federal statutes should be construed as requiring the continuation of a burden that the respondent assumes the plan should remove. It may well be asked why there should be delay in removing the burden and with it the interim preference to Terminal Company bondholders which is not justified by any discernible public interest.

Respondent objects to our statement in this connection that the solution of the Terminal Company problem lies in its reorganization, characterizing it as "a rather obvious red herring" drawn "across the trail" (Respondent's Brief, p. 63). But the red herring is that of respondent in identifying payment to Terminal Company bondholders with the public interest in continued operation. Apparently our argument on this score has been misunderstood. What we wished to emphasize in our brief, and now emphasize here, is that nothing in Section 77(c)(6), Section 124a or Section 124 requires New Haven creditors to support Terminal Company bonds in order to delay a necessary reorganization of the Terminal Company or for any other reason. That company is clearly in

need of reorganization,* and surely the reorganization sections of the Bankruptcy Act should assist the process, not interfere with it as respondent suggests. And, in any event, the order complained of simply directed the New Haven trustees not to advance New Haven funds to pay respondent's bondholders.

Throughout respondent's argument under the due process clause it also assumes that the New Haven corporation and petitioners are now liable for the taxes and bond interest by reason of the provisions of the Massachusetts Act of 1896. We have shown in subdivision (1) of our brief (pp. 11-16) that this is not the

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* In the Report, cited on page 4 of the respondent's brief, of the Special Commission to Investigate Railroad Transportation Facilities within the Commonwealth, created under Chapter 64 of the Massachusetts Resolves of 1939, the statement is made (p. 26) that "In 1920 the New Haven system carried in and out of Boston 33,896,680 passengers, but in 1938 only 13,406,223, and in 1939 only 12,529,685. It is estimated that for 1940 this number will decrease to about 11,500,000. The Old Colony Railroad [*i. e.*, Old Colony rails] carried in and out of Boston 13,582,806 passengers in 1920 (via Atlantic, excluding Neponset and Mattapan branches), but this number had decreased to 7,500,072 in 1938, and 7,026,752 in 1939. It is estimated that in 1940 this number will shrink to about 6,000,000." A table on that page and on the following page of the report shows a practically continuous decrease in passenger travel in and out of Boston on the New Haven System since 1920. On page 117 the report discusses "possible methods of reducing the charges allotted to the railroads using the South Station." It suggests (1) A five rod tax exemption (pp. 117-118) for each of the railroads whose lines enter South Station, and (2) a decrease in interest rates on Terminal Company bonds and a reduction of taxes on Terminal Company real estate (pp. 118-120). It concludes as follows (p. 120): "As this report indicates, the crux in the solution of the Boston Group problem, and the inclusion of the Old Colony as a part of the reorganized New Haven, lies in a solution of the difficulties of the Boston Terminal Company. The cooperation of all groups and interest [*sic*] is necessary to solve this problem. All parties should endeavor not to bring into existence great difficulties in a transportation problem which is already complex."

case. Moreover, the Circuit Court of Appeals required payment of the taxes and bond interest from cash in the New Haven estate whether or not the New Haven corporation or that estate were liable for them by State law saying that

> "In the view which we have taken of the case, it is not necessary for us to decide whether the provisions of the Massachusetts Act of 1896"

continue to bind the New Haven estate after rejection of the lease. It held that the New Haven Trustees must pay "in any event".

Conclusion.

We urge that the various Federal statutes in issue here do not mean what the Circuit Court of Appeals said they mean. Furthermore, we urge that if they do mean what the Circuit Court of Appeals said they mean they are unconstitutional. Respondent's brief fails to meet and answer our arguments.

Respectfully submitted,

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